Docket: 2017-4185(IT)G

BETWEEN:

COLIN WOOD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on January 8 and 9, 2020, at Toronto, Ontario

Before: The Honourable Justice Dominique Lafleur

Appearances:

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| Counsel for the Appellant: | Osborne G. Barnwell |
| Counsel for the Respondent: | Devon E. Peavoy |

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**JUDGMENT**

The appeals from reassessments made under the *Income Tax Act* for the 2011 and 2012 taxation years are dismissed, with one set of costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 19th day of August 2020.

"Dominique Lafleur"

Lafleur J.

Citation: 2020 TCC 87
Date: 20200819
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BETWEEN:

COLIN WOOD,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

**REASONS FOR JUDGMENT**

Lafleur J.

I. OVERVIEW

[1] Mr. Colin Wood ("Mr. Wood" or the "Appellant") appealed to this Court reassessments, the notices of which are dated March 14, 2016, made by the Minister of National Revenue (the "Minister") under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act"), for the 2011 and 2012 taxation years.

[2] According to the Minister, Mr. Wood failed to report net business income totalling $226,613 and $195,085 for 2011 and 2012 respectively. During those years, Mr. Wood carried on a business through his sole proprietorship, CW Marketing. The Minister also assessed penalties under subsection 163(2) of the Act for both taxation years. Furthermore, the notice of reassessment for the 2011 taxation year was issued beyond the normal reassessment period under subsection 152(4) of the Act.

[3] At the hearing, Mr. Wood and his accountant, Mr. Glen Lancaster testified, as did the Canada Revenue Agency ("CRA") auditor, Ms. Darcy Jackson, who conducted the audit of Mr. Wood's tax affairs.

[4] In these reasons, all references to statutory provisions are to those of the Act. I will also refer to Mr. Wood or to CW Marketing interchangeably.

## II. PRELIMINARY ISSUE: STATUTE-BAR ISSUE

[5] The Respondent is of the view that I should not address the issue of whether the Minister can reassess for the 2011 taxation year beyond the normal reassessment period on the basis that Mr. Wood has made a ". . . misrepresentation that is attributable to neglect, carelessness or wilful default or has committed . . . fraud in filing [a] return . . ." as contemplated by subparagraph 152(4)(a)(i). The Respondent noted that this issue was not raised in either the original Notice of Appeal filed in October 2017 or the Fresh as Amended Notice of Appeal filed in March 2018.

[6] In *DiCosmo v. The Queen*, 2017 FCA 60, the Federal Court of Appeal stated that the issue of whether an assessment is statute-barred must be specifically pleaded in order to ensure fairness and to permit all evidence to be put before the Court. In that decision, the Court upheld the decision of Justice Woods (*DiCosmo v. The Queen*, 2015 TCC 325), who had declined to consider the issue of whether an assessment was statute-barred because the issue was not raised in the Notice of Appeal. Justice Woods made the following comments:

> [8] . . . Taxpayers are required by the applicable Rules of the Court to state in their notices of appeal basic information as to the appeal, including the issues to be decided. Fairness dictates that the Crown can rely on these statements. In Mr. DiCosmo's notice of appeal, he states the issues to be decided and the statute bar issue is not among them. Accordingly, the Crown properly led no evidence on this point. It would be unfair to the Crown to have the Court consider this issue and I decline to do so.

[7] In the case at bar, the Respondent pointed out in the original Reply and in the Reply to the Fresh as Amended Notice of Appeal that Mr. Wood did not raise subsection 152(4) in his pleadings (or in the notice of objection served for the 2011 taxation year) and therefore, that subsection was not at issue. The Appellant would have received the original Reply referring specifically to subsection 152(4) before the Fresh as Amended Notice of Appeal was prepared and filed by counsel for the Appellant. Even though Mr. Wood was self-represented when he filed the original Notice of Appeal, he later retained counsel and the Fresh as Amended Notice of Appeal was filed by counsel. The Respondent's notice in her pleadings gave Mr. Wood and his counsel an opportunity to raise the issue in the amended pleadings, but they did not do so.

[8] Therefore, for reasons of fairness and given that the statute-bar issue was not raised by the Appellant in his pleadings, and also given the fact that the

Respondent twice gave notice to Mr. Wood and his counsel that subsection 152(4) had not been put in issue, I find that the statute-bar issue is not properly before the Court and I decline to consider it.

## III. ISSUES

[9] The issues to be decided are:

i) whether amounts totalling $226,613 and $195,085 should be added in the calculation of Mr. Wood's net business income for the 2011 and 2012 taxation years respectively; and

ii) whether penalties under subsection 163(2) should be assessed for the 2011 and 2012 taxation years.

## IV. THE LAW

[10] The applicable provisions of the Act are section 3, subsections 9(1), 163(2) and 163(3), which are reproduced in Annex A attached hereto.

## V. THE FACTS

### 5.1 The Auction Business: 2011

[11] In 2011, Mr. Wood was involved in a business that provided online penny auctions via a website called “bidwee.com” (the “Auction Business”).

[12] Mr. Shivdat Ganesh owned and operated the Auction Business as a sole proprietorship under the name SG Marketing. Mr. Wood, operating as a sole proprietorship called CW Marketing, provided order fulfilment, shipping, and customer services as a subcontractor. A corporation called MJ Marketing Ventures Inc. (“MJ Marketing”), which is owned by Mr. Martin Juchniewicz, a lifelong friend of Mr. Wood, was also subcontractor.

[13] The website began operating in August 2011 following six months of preparation. Bidders paid a non-refundable fee to place a small incremental bid. Each bid extended the clock, and the goal was to be the highest bidder when the clock stopped. Unlike most auctions, where only the winner pays, this method generated profit because everyone paid to bid using credit cards. Payments would go through Moneris (Royal Bank of Canada’s processing system) into

SG Marketing's merchant account at the Royal Bank of Canada ("RBC"). According to Mr. Wood, SG Marketing paid him a commission based on sales, which was transferred directly into his bank account at RBC.

[14] The Auction Business was very successful, making approximately $1.6 million in sales, until its fourth or fifth week of operation when Moneris froze SG Marketing's merchant account because of the excessive volume of transactions. This led to the website's shutdown, the Auction Business's demise, and litigation involving Mr. Ganesh, SG Marketing, Mr. Glen Lancaster (the accountant of Mr. Wood, Mr. Ganesh and Mr. Juchniewicz), Moneris, RBC, Harris Bank and an American party. According to Mr. Wood's testimony, the litigation started in late 2011 or early 2012.

[15] In 2018 or early 2019, the parties ultimately settled. SG Marketing had to pay US$150,000 to RBC and forfeit US$550,000, which represented the balance of funds in the frozen merchant account.

[16] In the meantime, the bidders asked for their money back. The business started refunding customers. It also offered chargebacks, which enabled customers to cancel a payment in full through their credit cards. As a result, there was approximately one million dollars of refunds and chargebacks; SG Marketing's merchant account balance quickly became negative. However, Mr. Wood's bank account was not affected.

5.2 The DVD Business: 2012

[17] In 2012, Mr. Wood sold DVDs online under the CW Marketing name and in collaboration with MJ Marketing (the "DVD Business").

[18] Mr. Wood took care of order fulfilment, shipping and customer service. MJ Marketing managed the website and handled advertising. Customers paid for DVDs online using credit cards. These credit card transactions were processed through Moneris or TD Merchant Services, which would deduct a fee and deposit the remaining balance in Mr. Wood's merchant accounts. This money was then transferred into his American bank account and finally into his Canadian bank account.

[19] Since Mr. Wood received all the income, he would pay all expenses, such as shipping costs, advertising and employees' salaries.

[20] Mr. Wood's merchant accounts were shut down in 2012 because of the high volume of refunds and chargebacks.

5.3 The criminal charges: 2013

[21] In the middle of 2013, Mr. Wood was charged with fraud, organized crime and possession of the proceeds of crime in relation to the DVD Business. The police seized all of his business records, computers and equipment.

[22] Mr. Wood pleaded guilty to a charge of fraud against Moneris. In November 2014, he was ordered to pay a fine and restitution totalling $130,000. This criminal matter concluded while Mr. Wood was under audit by the CRA.

[23] According to Mr. Wood's testimony, the police refused to send back the business records and his belongings.

## VI. POSITIONS OF THE PARTIES

6.1 Appellant's position

[24] With regard to 2011, the Appellant argues that the unreported amount was unearned income which lacks the quality of income under the Act and is therefore not taxable. These amounts were paid by SG Marketing to Mr. Wood to cover his expenses, i.e., buying products for auction, and in anticipation of future work, i.e., shipping products to the auction winners. However, the earning cycle was never completed because Mr. Wood could no longer ship products following the website's shutdown. Furthermore, Mr. Wood was uncertain whether he would need to pay back the money to SG Marketing because of customer refund requests or to Moneris because of the impending lawsuit.

[25] The Appellant compared unearned income to bad debt and referred the Court to the decision of *Flexi-Coil Ltd. v. The Queen*, 96 DTC 6350, [1996] F.C.J. No. 811 (QL) (FCA), in arguing that when a bad debt becomes uncollectible is a matter of the taxpayer's own judgment as a prudent businessperson and that this Court should defer to Mr. Wood's business judgment.

[26] The Appellant also pointed to the Supreme Court of Canada's decision in *Ikea Ltd. v. Canada*, [1998] 1 S.C.R. 196, at paragraph 37, 1998 CanLII 848 (*Ikea),* where the Supreme Court held that income is earned when the taxpayer's right to the income is absolute and under no restriction, contractual or otherwise, as

to its disposition, use or enjoyment. As Mr. Wood's right to the income from SG Marketing was not absolute, it was therefore not taxable.

[27] With respect to 2012, the Appellant argues that additional business expenses totalling $193,643 paid to MJ Marketing for advertising and marketing services performed in the DVD Business should be allowed as a deduction in the calculation of Mr. Wood's business income.

[28] Regarding the penalties assessed under subsection 163(2), Mr. Wood argues that he does not meet the threshold of gross negligence because he exercised his business judgment and consulted with his accountant, who has some 30 years' experience and upon whom he had relied for 15 years.

6.2 Respondent's position

[29] The Respondent argues that the amounts paid to Mr. Wood from SG Marketing/Mr. Ganesh in 2011 were taxable as commission income received by him. These amounts were not wrongfully paid to Mr. Wood. Furthermore, Mr. Wood did not identify which transfers related to goods or services not yet provided. Litigation was on the horizon, but the money Mr. Wood received in 2011 was still income for income tax purposes. Not knowing if one will need to pay money back in the future does not change whether or not the money is income in a tax year. Mr. Wood simply offered reasons why he was confused about reporting the income. Although most transfers were from SG Marketing, some were from other sources, which Mr. Wood did not explain.

[30] Further, these payments were not unearned income because Mr. Wood's right to the income was absolute and subject to no restriction or conditions. SG Marketing never demanded the money back, and Mr. Wood never paid it back.

[31] Generally, income must be reported and taxed in the year received. Further, paragraph 12(1)(a) provides that a taxpayer must report income received for goods or services not yet delivered. However, the Appellant did not adduce any evidence in that respect.

[32] Regarding 2012, the Respondent argues that this Court should not accept the authenticity of the invoices/receipts purportedly issued by MJ Marketing and adduced in evidence at the hearing to support the additional deduction because (1) they were submitted at a very late stage in this dispute, (2) Mr. Juchniewicz was a lifelong friend of Mr. Wood and (3) Mr. Juchniewicz did not testify.

Mr. Wood also never explained the business purpose of the expenses. The invoices merely say "Ads/Marketing", yet represent significant amounts of money.

[33] Finally, the penalties assessed under subsection 163(2) should be maintained because Mr. Wood intentionally chose not to report the income in 2011. He also never had a bookkeeper to help him keep track of income and expenses.

## VII. ANALYSIS

[34] For the following reasons, the appeals for the 2011 and 2012 taxation years are dismissed, with one set of costs to the Respondent.

### 7.1 The burden of proof

[35] The Minister is not bound by a return or information supplied by a taxpayer, or on his or her behalf, and may use an alternative audit method to assess the tax payable (subsection 152(7)).

[36] In the case at bar, Ms. Jackson used the deposit method, which is an acceptable alternative audit method.

[37] In *Cantore v. The Queen*, 2010 TCC 367, at paragraph 12, Justice Hogan described the deposit method as follows:

> The deposit method is based on an analysis of all deposits made in all of the taxpayer's bank accounts. Deposits are assumed by the Minister to constitute taxable revenue. Net income is determined by subtracting transfers of funds among the taxpayer's bank accounts and also borrowings by the taxpayer. The deposit method has been accepted by this Court as an appropriate alternative audit technique.

[38] Ms. Jackson obtained banking and credit card statements through the banks because Mr. Wood did not provide any documents during the audit. Her understanding was that MJ Marketing and CW Marketing were partners in a DVD business. Ms. Jackson also conducted the audit of MJ Marketing's and Mr. Juchniewicz's tax affairs. She asked for a reconciliation of advertising expenses, purchases and shipping expenses but never received any such reconciliation from Mr. Wood or his accountant. She was therefore not able to do a reconciliation of all expenses claimed by Mr. Wood.

[39] As a general rule, in tax appeals, the burden of proof rests on the taxpayer. Mr. Wood thus bears the burden of demolishing the Minister's assumptions of fact and proving on a balance of probabilities the facts justifying his position, while the Minister has the burden of proving on a balance of probabilities the facts justifying the assessment of penalties (subsection 163(3)).

[40] In order to successfully challenge the reassessments at issue, Mr. Wood must present detailed and cogent testimony, and supporting evidence where possible, to explain the various deposits found in his bank accounts and why they should not be included in the calculation of his income. For example, Mr. Wood can succeed either by establishing on a balance of probabilities new facts, not considered by the Minister, showing that the unreported income was not taxable, or by demonstrating that the Minister's assumptions of fact are wrong.

[41] There is also a second way to challenge a net worth assessment (or an assessment made using the deposit method), namely, to show that it is somehow inherently flawed. As Justice Bowman, as he then was, explained in *Bigayan v. The Queen*, 2000 DTC 1619, 1999 CanLII 86 (TCC), at paragraphs 3-4:

> 3 The best method of challenging a net worth assessment is to put forth evidence of what the taxpayer's income actually is. A less satisfactory, but nonetheless acceptable method is described by Cameron J. in *Chernenkoff v. Minister of National Revenue*, 49 DTC 680 at page 683:
>
> > In the absence of records, the alternative course open to the appellant was to prove that even on a proper and complete "net worth" basis the assessments were wrong.
>
> 4 This method of challenging a net worth assessment is accepted, but even after the adjustments have been completed one is left with the uneasy feeling that the truth has not been fully uncovered. Tinkering with an inherently flawed and imperfect vehicle is not likely to perfect it. The appellant chose to use the second method.

[42] It is possible that the Appellant's burden will not be met if the Respondent successfully challenges the evidence adduced at the hearing, if the evidence is contradictory or if the Court draws a negative inference from the Appellant's failure to produce available material evidence. Thus, Mr. Wood's credibility and the sufficiency of his evidence will be determinative (*Landry v. The Queen*, 2009 TCC 399, at paragraph 47, 2009 DTC 1359; *Roy v. The Queen*, 2006 TCC 226, 2008 DTC 3224). This Court, however, may also consider the

overall reasonableness of the reassessments in its determination of whether to allow the appeals.

[43] When assessing the credibility of a witness, I can consider inconsistencies, the attitude and demeanour of the witness, motives the witness may have to fabricate evidence, and the "overall sense of the evidence". As stated by Justice Valerie Miller in *Nichols v. The Queen*, 2009 TCC 334, 2009 DTC 1203, at paragraph 23:

> [23] In assessing credibility I can consider inconsistencies or weaknesses in the evidence of witnesses, including internal inconsistencies (that is, whether the testimony changed while on the stand or from that given at discovery), prior inconsistent statements, and external inconsistencies (that is, whether the evidence of the witness is inconsistent with independent evidence which has been accepted by me). Second, I can assess the attitude and demeanour of the witness. Third, I can assess whether the witness has a motive to fabricate evidence or to mislead the court. Finally, I can consider the overall sense of the evidence. That is, when common sense is applied to the testimony, does it suggest that the evidence is impossible or highly improbable.

[44] For the following reasons, which I shall elaborate upon later herein, I find that Mr. Wood did not show that the Minister's assumption that he failed to report gross business income totalling $236,956 and $1,154,356 in 2011 and 2012 respectively was wrong. I also find that amounts totalling $226,613 and $195,085 have to be added in the calculation of Mr. Wood's net business income for the 2011 and 2012 taxation years respectively.

[45] Mr. Wood did not oppose the inclusion of the amount of $1,154,356 in the calculation of his gross business income for 2012, and he failed to establish on a balance of probabilities either the non-taxable nature of the amounts received from SG Marketing/Mr. Ganesh and from others in 2011 or the authenticity of the three MJ Marketing invoices submitted as evidence justifying the deduction of additional business expenses for 2012.

[46] There was simply a lack of evidence on some material facts, specifically, on the nature of the amounts received from SG Marketing/Mr. Ganesh and others in 2011 and on the purported additional business expenses in 2012. I also find Mr. Wood's and Mr. Lancaster's testimony to be unreliable and not credible in many respects.

[47] Further, I find that the Minister has established on a balance of probabilities the facts justifying the penalties assessed under subsection 163(2) for both taxation years.

7.2 The Auction Business: 2011

[48] As regards 2011, Ms. Jackson concluded that sales revenue should be increased by $236,956 and that an amount totalling $226,613 had to be added to Mr. Wood's net business income after taking into account a deduction of $10,343 for bank charges allowed. Apart from the bank charges expense, Ms. Jackson assessed the expenses as claimed by Mr. Wood in his return.

[49] During the audit, Mr. Wood indicated to Ms. Jackson that the proposed increased sales revenue figure represented amounts SG Marketing had reimbursed to him for expenses paid by him on behalf of SG Marketing. Ms. Jackson tried to obtain confirmation from SG Marketing of the nature of these transfers but she never received an answer to her request. One of the cheques indicates that it was for "Advertising & Support" while the others did not identify the nature of the payment.

[50] A review of Mr. Wood's Moneris and TD merchant account statements showed total sales of $253,773. A review of Mr. Wood's various bank account statements showed various deposits (by cheque, draft or other types of transfer) made by SG Marketing, SGCW Worldwide Media Inc., JS Marketing/Justin Sims and Mr. Ganesh totalling $260,873. Hence Ms. Jackson concluded that Mr. Wood's total sales were $514,646. However, Mr. Wood reported only $277,690 on his tax return, a difference of $236,956.

[51] A review of the evidence adduced at trial also indicates that amounts received from SG Marketing/Mr. Ganesh totalled $232,373: deposits into Mr. Wood's bank accounts started on July 4, 2011 and ended on September 16, 2011. Mr. Wood also received from SGCW Worldwide Media Inc., in February and March 2011, amounts totalling $6,400 and from Justin Sims/JS Marketing, in April and December 2011, amounts totalling $22,100.

7.2.1 Nature of the amounts received from persons other than SG Marketing/Mr. Ganesh

[52] Mr. Wood did not submit any evidence as to the nature of the amounts totalling $28,500 received from persons other than SG Marketing/Mr. Ganesh

during the 2011 taxation year. Given the absence of evidence on the nature of these amounts, I shall consider them as taxable under the Act and as having been properly included in the calculation of Mr. Wood's gross business income.

7.2.2 Nature of the amounts received from SG Marketing/Mr. Ganesh

[53] As for the amounts transferred into Mr. Wood's bank accounts by SG Marketing/Mr. Ganesh, I find that they were commissions for services rendered by Mr. Wood to SG Marketing in 2011. Therefore, the amount of $232,373 was taxable and properly included in the calculation of Mr. Wood's gross business income in 2011.

*The Appellant's testimony*

[54] Mr. Wood's testimony at trial was inconsistent with prior statements made to the CRA as well as statements made in the notice of objection and in the Fresh as Amended Notice of Appeal. Mr. Wood's testimony was confusing, unclear and seemed incomplete, and therefore on that basis I find it to be unreliable and not credible. Mr. Wood did not meet his burden of establishing, even on a *prima facie* basis, that the amounts transferred by SG Marketing/Mr. Ganesh into his bank accounts should not be included in the calculation of his gross business income. No evidence was adduced at trial as to the actual amounts, if any, representing payments for services to be rendered later and for which a reserve could be claimed under the Act, or representing a loan or advance of some sort.

[55] During the audit, which lasted from 2014 to 2016, Mr. Wood had indicated to Ms. Jackson that the amounts paid to him by SG Marketing/Mr. Ganesh represented the repayment of loans made to SG Marketing. However, at the audit stage, Mr. Wood did not adduce evidence of any loan or advance made to SG Marketing.

[56] At the administrative appeal stage, despite his claim in the notice of objection that the loan to SG Marketing could be verified by audited financial statements prepared by SG Marketing, Mr. Wood never provided any documents or any type of evidence to substantiate his claim.

[57] Paragraphs 3 and 9 of the Fresh as Amended Notice of Appeal, dated March 15, 2018, refer to amounts received from SG Marketing as "commissions" for Mr. Wood's services and not as the repayment of a loan. Those paragraphs read as follows:

> 3. The fee arrangement for [Mr. Wood's] services was that he received a commission based on his sales. This was a built-in amount in the sales made in the online auction.
>
> . . .
>
> 9. [Mr. Wood] . . . sincerely believed that it was best that the commissions he received NOT be reported as his income at that time, as the resolution of the law suit may very well involve the claw back of the commissions plus other costs.

[58] At trial, Mr. Wood testified that he had put time and money into the Auction Business during the six months it took to set up the business. However, Mr. Wood added that he never discussed with Mr. Ganesh whether the expenses he had incurred were a loan (advances) to SG Marketing, and he stated that in fact he did not consider the amount received afterwards as a repayment of a loan. Yet he later testified that, after the crash of the Auction Business, Mr. Ganesh told him that the various amounts paid by SG Marketing/Mr. Ganesh could be considered as a loan from SG Marketing to cover the work Mr. Wood had done before the business was launched and that they would discuss repayment later. Mr. Wood recognized that Mr. Ganesh never demanded repayment of these amounts.

[59] Furthermore, Mr. Wood also testified that he received funds from SG Marketing for orders that had already been shipped, for orders waiting to be shipped and for orders awaiting a winner at auction. The amounts received from SG Marketing/Mr. Ganesh were paid to cover his expenses (to buy products for auction) and in anticipation of future work (to ship products to the auction winners). However, as indicated above, no evidence was adduced at trial as to the quantum of these different types of payments, if any were made.

*The failure to call Mr. Ganesh as a witness*

[60] In *Imperial Pacific Greenhouses Ltd. v. The Queen*, 2011 FCA 79, at paragraph 14 (*Imperial Pacific)*, the Federal Court of Appeal stated that a Tax Court judge can draw an adverse inference from a party's failure to call a witness, especially if the witness's evidence would have been central to establishing an important fact.

[61] In the case at bar, Mr. Ganesh's testimony was central to establishing the nature of the amounts transferred by SG Marketing/Mr. Ganesh into Mr. Wood's bank accounts, that is, whether they were repayment of advances made by Mr. Wood during the set-up phase of the business, or loans made by

SG Marketing/Mr. Ganesh during the operation of the business (e.g., to cover Mr. Wood's expenses), or commissions for services rendered or to be rendered (e.g., for future work).

[62] Mr. Wood did not call Mr. Ganesh to testify and I did not receive any credible explanation justifying Mr. Ganesh's absence. I find that I should draw an adverse inference from the Appellant's failure to call Mr. Ganesh at the hearing and that Mr. Ganesh's testimony would have been unfavourable to Mr. Wood.

[63] Furthermore, I also conclude that it would have been reasonable to expect that there would have been adduced at the hearing documentation describing the relationship between the various parties to the Auction Business and their obligations towards each other. I acknowledge that Mr. Wood had a problem adducing such documentation on account of the police seizure of books and records, but Mr. Ganesh could have been summoned to bring the relevant documentation. That documentation would have allowed the Court to make a finding as to the nature of the payments made by SG Marketing/Mr. Ganesh to Mr. Wood.

*The accountant's testimony was unreliable*

[64] Mr. Lancaster's testimony regarding the Auction Business was surprisingly vague at times. I also find his testimony regarding the nature of the amounts received by Mr. Wood to be unreliable. Mr. Lancaster testified that in preparing Mr. Wood's 2011 tax return it was difficult to discern whether the amounts paid to Mr. Wood by SG Marketing/Mr. Ganesh should be included in income, whether they were funds used to procure products for the bidding, or whether they were funds belonging to Moneris.

[65] Mr. Lancaster also testified that he did not have access to Mr. Wood's business records because the police had seized them. However, the evidence shows that Mr. Wood's business records were only seized by the police in the middle of 2013. That means that in 2012 all business records were available for the purpose of making a determination on the nature of the amounts received by Mr. Wood. In addition, Mr. Lancaster was also Mr. Ganesh's and SG Marketing's accountant. It would have been easy for him to obtain the necessary information.

[66] In addition, Mr. Lancaster struggled to remember the name of the business, and he could not remember when the lawsuit commenced, even though he was named as a defendant in that lawsuit.

[67] I also note that in the notice of objection prepared by him in 2016, Mr. Lancaster indicated that the various amounts paid by SG Marketing/Mr. Ganesh represent repayment of a loan, that the amount of the loan could be verified by audited financial statements prepared by SG Marketing and that these documents could be submitted upon request. He further indicated that expenses were paid by Mr. Wood on behalf of SG Marketing but were not taken into consideration. The notice of objection was filed in 2016, that is, four years after the litigation supposedly commenced. Given that time lag, I find that Mr. Wood and Mr. Lancaster had sufficient time to make a determination as to nature of the amounts in question. Mr. Lancaster and Mr. Wood did not make reasonable efforts to determine the nature of the amounts received from SG Marketing/Mr. Ganesh. Mr. Lancaster testified that he did not have all the facts needed to enable him to form an opinion. However, as I have concluded above, in 2012 Mr. Wood and Mr. Lancaster had access to all the documentation required in order to make that determination.

*Unearned income argument*

[68] Finally, I will turn to the unearned income argument raised by the Appellant, which does not stand up.

[69] According to the Act, the income of a taxpayer for a taxation year includes the taxpayer's income for the year from each business of the taxpayer (paragraph 3(a)). Subsection 9(1) provides that ". . . a taxpayer's income for a taxation year from a business . . . is the taxpayer's profit from that business . . . for the year."

[70] As indicated by the Supreme Court of Canada in *Canderel Ltd. v. Canada* [1998] 1 S.C.R. 147, at paragraphs 29, 50 and 53, 98 DTC 6100, when determining profit, a taxpayer is free to employ whichever method will be most useful, provided the method adopted is not inconsistent with well-accepted business principles, the Act and established case law principles and yields an accurate picture of profit for the year. The determination of profit is a question of law and must take into account any applicable express provisions of the Act.

[71] In *Ikea* (paragraph 37), the Supreme Court of Canada stated that any amounts having the quality of income that are received or realized by a taxpayer free of conditions or restrictions upon their use are taxable in the year received or realized, subject to any contrary provisions of the Act or other rule of law.

[72] As indicated above, no evidence was adduced at trial as to which, if any, amounts received by Mr. Wood related to services not yet provided or as to whether any amounts paid to Mr. Wood were wrongfully paid to him. As indicated in the Fresh as Amended Notice of Appeal, Mr. Wood received commissions from SG Marketing for services rendered. No reliable and credible evidence was adduced as to the existence of any conditions or restrictions attached to these amounts. Therefore, I find that the amount totalling $232,373 was properly included in the calculation of Mr. Wood's gross business income.

7.3 The DVD Business: 2012

[73] As regards 2012, Ms. Jackson concluded that sales revenue should be increased by $1,154,356 and that an amount totalling $195,085 had to be added to Mr. Wood's net business income. As for 2011, Ms. Jackson was not able to do a reconciliation of the expenses totalling $1,360,078 claimed by Mr. Wood in his 2012 tax return. She decided to accept the expenses as claimed and allowed additional deductions totalling $959,271.

[74] A review of Mr. Wood's Moneris and TD merchant account statements showed total sales of $3,094,415, but Mr. Wood reported only $1,940,059 in his tax return, the difference being the amount of $1,154,356.

[75] Mr. Wood did not oppose the inclusion of an amount of $1,154,356 in the calculation of his gross business income. However, he argues that additional expenses totalling $193,643 for advertising and marketing services performed by MJ Marketing should be allowed as a deduction. He submitted copies of three invoices/receipts (the "Three Invoices") purportedly issued by MJ Marketing, dated June 30, 2012, July 31, 2012 and August 31, 2012, to which were attached copies of Mr. Wood's business bank account statements evidencing various cash withdrawals totalling $193,643.

[76] Mr. Wood testified that MJ Marketing was paid in cash for its services since there was no limit for cash withdrawals from his bank account whereas there was a limit on e-transfers. There were nine cash withdrawals relating to the first invoice, eight relating to the second and seven relating to the third.

[77] For the reasons set out below, I find that Mr. Wood failed to establish on a balance of probabilities that additional expenses totalling $193,643 should be allowed.

*The audit*

[78] During the audit, Ms. Jackson did not receive copies of the Three Invoices. Ms. Jackson also testified that she did not inquire about the many large cash withdrawals from Mr. Wood's bank accounts.

[79] The evidence shows that Ms. Jackson did not do an audit of the expenses claimed by Mr. Wood because of a lack of documentation. Ms. Jackson accepted the expenses as claimed. These totalled $1,360,078, which included advertising expenses totalling $631,807 and other expenses (including shipping) totalling $561,583.

[80] She also allowed the following additional deductions: $415,654 for bank charges, $358,700 for payments made by cheque, e-transfer and draft to MJ Marketing's bank account, and $184,917 for sales discrepancies. The Appellant made no attempt to reconcile the additional expenses and the expenses already allowed by the auditor. It is possible then that the former were amongst those already allowed at the audit stage, since the auditor allowed $631,807 in advertising expenses, presumably paid to MJ Marketing.

[81] Ms. Jackson did not consider any cash withdrawals as allowable expenses in the calculation of Mr. Wood's business income. She testified that in MJ Marketing's bank account the majority of the deposits were made by e-transfer and that Mr. Juchniewicz had stated during the audit that any amount received from CW Marketing was by way of electronic transfer. Furthermore, Ms. Jackson could not find corresponding deposits in MJ Marketing's bank account.

[82] After Ms. Jackson had reviewed the Three Invoices, she concluded that it did not make sense to conclude that the invoices represented amounts paid to MJ Marketing, because there was a history of e-transfers between CW Marketing and MJ Marketing. Furthermore, on MJ Marketing's bank statements, e-transfers appeared but no cash deposits of such substantial amounts as those indicated on the Three Invoices. I agree with Ms. Jackson.

*The failure to call Mr. Juchniewicz as a witness*

[83] As indicated above, in *Imperial Pacific*, the Federal Court of Appeal stated that a Tax Court judge can draw a negative inference from a party's failure to call a witness, especially if the witness's evidence would have been central to establishing an important fact.

[84] In the case at bar, Mr. Juchniewicz's testimony was central to establishing the authenticity of the Three Invoices as well as to establishing the fact that an amount of $193,643 was paid to MJ Marketing in cash for advertising and marketing services rendered to CW Marketing, in addition to other amounts MJ Marketing had received from Mr. Wood by electronic transfer. Mr. Wood did not call Mr. Juchniewicz to testify and I did not receive any explanation justifying Mr. Juchniewicz's absence. I find that I should draw an adverse inference from the Appellant's failure to call Mr. Juchniewicz at the hearing and that Mr. Juchniewicz's testimony would not have been favourable to Mr. Wood.

*The authenticity of the Three Invoices*

[85] Furthermore, I do not accept the authenticity of the Three Invoices given the divergent testimony of Mr. Wood and Mr. Lancaster on the timing of the receipt of the invoices and the fact that the invoices were submitted very late in the process, that is, not before March 2018, hence after the audit and appeal.

[86] According to Mr. Wood's testimony, he did not receive the Three Invoices from MJ Marketing until after the audit that started in February or March 2014. However, Mr. Lancaster testified that he first saw the Three Invoices after filing Mr. Wood's income tax return for 2012, that is, after March 2013, but before the audit.

[87] Mr. Wood testified that either he or Mr. Lancaster submitted the Three Invoices to the CRA at some point, possibly with the notice of objection. Mr. Lancaster testified that he told Mr. Wood to submit the invoices to the CRA appeals officer, and according to Mr. Lancaster, Mr. Wood told him that he did. However, the CRA Appeals Division sent Mr. Wood a letter dated May 4, 2017 requesting documentation, which was never provided. Furthermore, according to Ms. Jackson, the CRA never received a copy of the Three Invoices during the audit or appeal stage. Ms. Jackson saw the invoices only when she was preparing for the appeal before this Court, that is, one year before the hearing of the case in this Court.

[88] In the absence of evidence of submission before that date, I find that Mr. Wood likely submitted the Three Invoices in March 2018 when he filed the Fresh as Amended Notice of Appeal with the Court. The fact that the notice of objection of May 2016 and the original Notice of Appeal of October 2017 indicate that invoices are available upon request suggests that the Three Invoices were

never previously sent to the CRA. Therefore, I find Mr. Wood's testimony not to be credible on this point.

[89] In addition, Mr. Wood testified that he was able to retrieve the Three Invoices because a laptop that Mr. Juchniewicz had with him at the time of the police raid was not seized. As the police raid occurred in the middle of 2013, I am left wondering about the reasons for not submitting the Three Invoices during the audit process, which started in February or March 2014. Mr. Wood would have had ample time to retrieve the Three Invoices and submit them to the CRA. The fact that he delayed submitting the Three Invoices casts considerable doubt on their authenticity, as does the fact that all cash withdrawals appearing on Mr. Wood's bank statements for the months of June, July and August 2012 are part of the total amounts appearing on the Three Invoices.

*Other facts*

[90] My conclusion is also supported by the following facts.

[91] Mr. Lancaster testified that he used bank statements (which would include Moneris and TD merchant account statements) to prepare Mr. Wood's income tax returns. Mr. Lancaster also prepared MJ Marketing's and Mr. Juchniewicz's tax returns. He interviewed both Mr. Wood and Mr. Juchniewicz, together and separately, to confirm the purposes of the various cash transactions and transfers between Mr. Wood and MJ Marketing and to make sure that if one claimed a deduction the other would include the same amount in income. That way he was able to ascertain MJ Marketing's revenue and make sure it aligned with the expenses claimed by Mr. Wood. Mr. Lancaster testified that the amount of the Three Invoices totalling $193,643 was included in the calculation of MJ Marketing's business income. Given the magnitude of the cash withdrawals, Mr. Lancaster certainly would have questioned Mr. Wood and Mr. Juchniewicz with regard thereto.

[92] Hence, given Mr. Lancaster's testimony, I find that, if the cash withdrawals of $193,643 were payment for advertising and marketing services performed by MJ Marketing, it was more likely than not that this amount was included in the total amount of $631,807 claimed originally by Mr. Wood as advertising expenses and accepted by the auditor as claimed.

7.4 Penalties for 2011 and 2012

[93] Pursuant to subsection 163(3), the Respondent has the burden of proving on a balance of probabilities the facts justifying the assessment of penalties against Mr. Wood under subsection 163(2) for both taxation years.

[94] Accordingly, in these appeals, the Respondent must establish facts showing, on a balance of probabilities:

> (i) that Mr. Wood made a false statement in his income tax returns;
>
> (ii) that Mr. Wood did so knowingly or under circumstances amounting to gross negligence.

[95] According to subsection 163(2), there are two elements that must be present in order for the penalty to apply: (1) a mental element: "knowingly, or under circumstances amounting to gross negligence"; and (2) a material element: "has made . . . a false statement or omission".

[96] Here, it was determined that Mr. Wood filed his income tax returns for the 2011 and 2012 taxation years.

[97] Also, it was determined, or at least it was not contested by Mr. Wood, that Mr. Wood did not report the totality of his gross business income for both taxation years. With respect to 2011, Mr. Wood did not report an amount of $236,956 that should have been added in the calculation of his income from taxable sources, resulting in an increase in his net business income of $226,613. For 2012, Mr. Wood did not report an amount of $1,154,356 in sales revenues, resulting in an increase in his net business income of $195,085. Thus, the material element exists in this case (*D'Andrea v. The Queen*, 2011 TCC 298, at paragraph 35).

[98] But what about the mental element? For the following reasons, I find that the evidence showed on a balance of probabilities that Mr. Wood made a false statement or omission in his tax returns for 2011 and 2012 under circumstances amounting to gross negligence. I also find that Mr. Wood knowingly made a false statement or omission in his tax return for 2011 by not reporting the amounts he received from SG Marketing/Mr. Ganesh and from other payors.

[99] In *Wynter v. The Queen*, 2017 FCA 195, a unanimous decision of the Federal Court of Appeal, Justice Rennie stated with respect to the "knowingly" and "gross negligence" standards in subsection 163(2):

> [11] When Parliament uses alternative terms, it is assumed that it intended them to have different meanings. Put otherwise, Parliament does not repeat itself: see Ruth Sullivan, *Statutory Interpretation*, 3rd ed. (Toronto: Irwin Law Inc., 2016) at 43. Section 163 allows the imposition of penalties where the taxpayer has knowledge *or* in circumstances amounting to gross negligence. The section is not conjunctive, and presumptively, these two terms differ in their meaning and content.
>
> [12] The distinction between gross negligence – determined by an objective assessment of the comportment of the taxpayer – and wilful blindness – determined by reference to the taxpayer's subjective state of mind – has a long history. Admittedly, it is, on occasion, a fine distinction and one that is not always clearly drawn. Nonetheless, Parliament is taken to have been cognizant of the distinction.
>
> [Emphasis in the original.]

[100] As stated by Justice Rennie (at paragraph 18 of his reasons), gross negligence arises where the taxpayer's conduct is found to fall markedly below what would be expected of a reasonable taxpayer. Also, as indicated by the Supreme Court of Canada in *Guindon v. Canada*, 2015 SCC 41, [2015] 3 S.C.R. 3, at paragraph 61, the penalties ". . . are meant to capture serious conduct, not ordinary negligence or simple mistakes . . . ."

[101] The concept of "gross negligence" was defined by Strayer J. in *Venne v. The Queen*, [1984] F.C.J. No. 314 (QL), 84 DTC 6247 at 6256 (FCTD):

> . . . "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not. . . .

[102] The "gross negligence" standard is an objective test (*Wynter*, paragraph 21). Gross negligence will be assessed by taking into account the expected conduct of a reasonable person in the same circumstances.

[103] Hence, in these appeals, the expected conduct of Mr. Wood will have to be measured against that of a reasonable taxpayer with the same business experience, that is, a person having operated a business for eight or nine years.

[104] According to Ms. Jackson, the penalties were justified since Mr. Wood was the owner and operator of the business, there was a lack of documentation provided and large amounts of unreported income were found. As Mr. Wood was

the owner and operator of the business, he should have known the extent of the income generated by the business. He oversaw all operations, he made the deposits, he was in charge of maintaining the books and records, and he prepared the spreadsheets.

[105] Here, I find that Mr. Wood's conduct in 2011 and 2012 showed a marked and substantial departure from the expected conduct of a reasonable businessperson in the same circumstances.

[106] Mr. Wood was grossly negligent since he had neither a bookkeeper nor accounting software to help him keep track of significant revenues and expenses. Mr. Wood's returns for both taxation years were prepared by his accountant before the police seizure of his records, yet the accountant relied only on bank statements (including the Moneris statements and credit card statements) as well as personal interviews. This practice departs markedly from the standard to be expected of a businessperson with eight or nine years' experience who is acting reasonably.

[107] Furthermore, Mr. Wood failed to provide a "viable and reasonable hypothesis" regarding the large amounts of unreported income in 2011 *(Lacroix v. The Queen*, 2008 FCA 241, at paragraph 29). Mr. Wood knowingly chose not to report the amounts received from SG Marketing/Mr. Ganesh and others. No evidence was adduced in respect of amounts received from other persons. As regards the amounts received from SG Marketing/Mr. Ganesh, the reasons provided for not reporting them were inconsistent and changed over time; at first it was because they were the repayment of a loan, then it was because they were commission income that might subsequently be clawed back and finally, it was because they were unearned income and did not have the quality of income under the Act. As indicated above in Section 7.2 "The Auction Business: 2011", I do not accept these arguments.

[108] For 2012, Mr. Wood did not provide any viable and reasonable hypothesis for not reporting the amount of $1,154,356. Mr. Wood only argued that additional expenses totalling $193,643 should be taken into account as a deduction in the calculation of his business income.

[109] Accordingly, I conclude that the penalties assessed under subsection 163(2) for 2011 and 2012 were justified.

## VIII. CONCLUSION

[110] For these reasons, the appeals for the 2011 and 2012 taxation years are dismissed, with one set of costs to the Respondent.

Signed at Ottawa, Canada, this 19th day of August 2020.

"Dominique Lafleur"

Lafleur J.

# ANNEX A

## *Income Tax Act*, R.S.C. 1985, c. 1 (5th supp.)

## Section 3

**3** The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:

**(a)** determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property,

**(b)** determine the amount, if any, by which

**(i)** the total of

**(A)** all of the taxpayer's taxable capital gains for the year from dispositions of property other than listed personal property, and

**(B)** the taxpayer's taxable net gain for the year from dispositions of listed personal property,

exceeds

**(ii)** the amount, if any, by which the taxpayer's allowable capital losses for the year from dispositions of property other than listed personal property exceed the taxpayer's allowable business investment losses for the year,

**(c)** determine the amount, if any, by which the total determined under paragraph (a) plus the amount determined under paragraph (b) exceeds the total of the deductions permitted by Subdivision e in computing the taxpayer's income for the year (except to the extent that those deductions, if any, have been taken into account in determining the total referred to in paragraph (a), and

**(d)** determine the amount, if any, by which the amount determined under paragraph (c) exceeds the total of all amounts each of which is the taxpayer's loss for the year from an office, employment, business or property or the taxpayer's allowable business investment loss for the year,

and for the purposes of this Part,

**(e)** where an amount is determined under paragraph (d) for the year in respect of the taxpayer, the taxpayer's income for the year is the amount so determined, and

**(f)** in any other case, the taxpayer shall be deemed to have income for the year in an amount equal to zero.

Subsection 9(1)

**9(1)** Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.

Subsection 163(2)

**163(2)** Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of

**(a)** the amount, if any, by which

**(i)** the amount, if any, by which

**(A)** the tax for the year that would be payable by the person under this Act

exceeds

**(B)** the amounts that would be deemed by subsections 120(2) and (2.2) to have been paid on account of the person's tax for the year

if the person's taxable income for the year were computed by adding to the taxable income reported by the person in the person's return for the year that portion of the person's understatement of income for the year that is reasonably attributable to the false statement or omission and if the person's tax payable for the year were computed by subtracting from the deductions from the tax otherwise payable by the person for the year such portion of any such deduction as may reasonably be attributable to the false statement or omission

exceeds

**(ii)** the amount, if any, by which

**(A)** the tax for the year that would have been payable by the person under this Act

exceeds

**(B)** the amounts that would be deemed by subsections 120(2) and (2.2) to have been paid on account of the person's tax for the year

had the person's tax payable for the year been assessed on the basis of the information provided in the person's return for the year,

[…]

Subsection 163(3)

**163(3)** Where, in an appeal under this Act, a penalty assessed by the Minister under this section or section 163.2 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.

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| PLACE OF HEARING: | Toronto, Ontario |
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APPEARANCES:

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